



1950

Monthly Letter on Economic Conditions Government Finance



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General Business Conditions

THE closing days of November have been a period of strain and anxiety in this country, caused by the sudden turn for the worse in the news from the Korean battlefield, and by the gravity of the crisis which the Chinese Communist intervention has created. Markets have reacted violently. Commodities have risen in expectation that demand will become even more intense, while common stocks have slumped in the belief that events will make taxation heavier, controls more drastic, and the disruption of peacetime production greater.

These are the precise opposite of market responses only a few days earlier, when hope was aroused that Chinese intervention would be nominal and that the war could be pushed to a quick end. Market actions are often impulsive, and whether the new developments are being correctly appraised remains to be seen. There will be agreement, however, as to the direction in which events point. They raise a clear presumption of expansion and quickening of armament programs.

The impact of rearmament has been felt increasingly during the month. Evidence accumulates that supplies of industrial materials will be short and their use restricted. The order of the National Production Authority limiting the use of aluminum in civilian products beginning January 1st, to 65 per cent of the level of the first half of 1950, is severe. A similar order cuts the consumption of copper to 85 per cent of the same base period during January and February and to 80 per cent in March. These will soon be followed by orders covering zinc and nickel. Steel supplies are tight and by all accounts will become increasingly so. Facing these materials difficulties, manufacturers of electrical appliances and other household equipment are preparing to curtail production, with cutbacks of around 25 per cent planned in many cases. The automobile industry will be affected also and some companies have already run into shortages of steel.

Shortages and Stockpiling

These scarcities are appearing before actual armament production is making any considerable demand on supplies. In part they are due to absorption of stocks by the enormous consumption of metals during the past few months. In part they reflect a scramble to keep covered in anticipation of future requirements. Most of all, they are due to government stockpiling.

Before the Korean war stockpile purchases of copper were absorbing 20,000 to 25,000 tons a month, and since Korea they have averaged around 15,000. Total holdings are estimated to be approaching 400,000 tons. With this diversion of supply, even before Korea the high civilian consumption was being met only by drawing down producers' and fabricators' stocks, which are now reduced to minimum levels. The limitation order is designed to bring consumption (excluding armament use) down to around 100,000 tons monthly. The prospective supply, including net imports, may run around 140,000 tons a month. Since the increase in armament

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use for some time ahead is not expected to exceed 15,000 tons, it appears that continuation of stockpiling at the recent rate is intended, and that stockpiling is the basic reason for the limitation order. In conversion deals copper has commanded up to 40 cents a pound.

Zinc stockpiling has been taking some 12,000 tons a month during most of 1950 and producers' stocks have almost disappeared. The zinc stockpile is around 475,000 tons. One of the important uses for copper and zinc is in making brass for shell casings, which requires 70 per cent copper and 30 per cent zinc. Thus the zinc stockpile is greatly excessive in relation to copper stocks. Meanwhile steel companies are curtailing galvanizing operations for lack of zinc, and it is reported that as high as 50c is asked in the gray market for high grade zinc used in die casting. Copper and zinc are only two examples of the part played by stockpile purchases in the developing scarcity of basic materials.

The Tightening Grip

Thus government programs are tightening their grip on the industries from two directions, — by reducing materials supplies as described and by curtailment of demand, which is the object of the regulations issued in October restricting the use of consumer credit and housing credit. These moves mark the real beginning of the impact of armament expansion on the economy. They usher in the period when the employment of labor, materials and factories for civilian purposes will be reduced by priorities and limitations and by checking demand, and when a shift of men and materials from peacetime work to war work must be brought about.

In terms of the outlook for business, the question is whether there will be a smooth transition, with work on armament orders taking up the slack in employment as civilian workers are released. It is not to be expected that friction and unsettlement can be wholly avoided. However, there is an encouraging record of experience. In the Fall of 1941 the same question was pressing, and of course in greater degree because of the relatively greater magnitude of the arms effort at that time. Many people took a pessimistic view of the ability of the economic organization to make the necessary shifts with minimum disturbance. The term "priorities unemployment" was coined, and labor leaders moved on Washington with demands for special relief measures, which in some sections of the government were warmly supported. Congress, however, was in no rush to act, and in a short time it became clear that the situation was never as bad as it had been described and that despite

confusion and mismanagement it was steadily curing itself.

The reverse of the experience came in 1945 and 1946 when, as everyone will remember, predictions of "reconversion unemployment" ranging up to 8 million people were common and proved to be woefully exaggerated.

While this experience is testimony to the ability of the economy to accomplish a shift in the use of resources with encouraging speed and effectiveness, it is nevertheless true that the principal responsibility must fall on the government authorities. If they move too early and too strongly in limiting civilian work before equivalent war orders are ready, they will bring about unnecessary unemployment, disruption of working forces and productive facilities, and loss of output. If they carry stockpiling to extremes, especially in the rate at which they buy, they will cause similar disruption by needlessly denying manufacturers materials. To take commodities off the market for the purpose of supplying arms requirements is one thing; to continue to build stockpiles rapidly in addition to supplying arms requirements, and thus in effect double-stockpiling, may be fairly criticized, in view of the effects already seen. Also, poor staff work in coordinating civilian cutbacks with the flow of arms orders, such as failing to spread orders with consideration for areas where cutbacks are particularly severe, can be costly.

The greatest uncertainty is the size of the war orders themselves and the speed with which they will be placed. The country does not know what the armament program is, for the plain reason that the Administration itself does not yet know. To the lack of definite figures up to this time is now added the immense uncertainty growing out of the Chinese action and the danger of expanding war. Between the possible minimum and the possible maximum of expenditures is a range so wide that no one can yet tell precisely what the requirements for materials and labor may be, or what degree of regimentation and control may be resorted to.

Outlook for Industrial Activity

Subject to these uncertainties, most elements in the present outlook favor continuation of high level production with a minimum of "priorities unemployment". Restrictions of supply now planned will leave the durable goods industries with enough materials to carry on production at a rate in most cases second only to 1950, and otherwise equal to or greater than in any other years. The ingenuity of the industries, and the vastly expanded facilities of their laboratories,

will be turned to finding and producing substitutes for scarce materials. Finally, the cutoff is not likely to be precipitous in all lines, but staggered. The building industry will be affected by the restrictions on housing credit, but will continue active in many kinds of non-residential construction; the Dodge Corporation estimates the drop in total construction at 19 per cent, compared with 35 per cent in the residential group. Home building still has considerable momentum. New starts in October, at 103,000, were still large by any measure. New residential contracts awarded in the same month were 6 per cent above last year, and in the first half of November 18 per cent higher.

In many segments of the economy, where no conversion problem exists, continuation of all-out production and employment is assured. Surveys of the intentions of the industries to spend on plant and equipment in 1950 indicate that the total will be even larger than in 1948, the previous peak year. Machine tool orders have been sensationally high ever since Korea; at the end of October the industry's backlog represented nearly a year's output at present rate of shipments, although shipments are more than half again as large as a year ago.

The high rate of investment in new productive facilities is one of the heartening aspects of the business news. To the extent that the armament needs can be met by increasing rather than by diverting production, disruption of the economy will be minimized and the inflationary danger will be more manageable.

State of Trade

In this discussion the question of demand so far has been passed over. The general view is that markets for durable goods will shrink in 1951, both because of the credit restrictions and the inevitable reaction from last summer's boom, during which business was borrowed from the future. On the other hand, these industries are more concerned about the curtailment they face than about their markets. For the most part they think they will be able to sell all they can make. Distributors appear to be willing to buy beyond their current needs in anticipation of shortages next year. They take this view even where some slackening in retail sales has appeared. Of course if they could count on getting next year all the merchandise they want, they would probably be less eager buyers now. But that is not the situation. The willingness to carry inventories and place forward commitments is one of the elements that can be expected to maintain activity.

Department store sales slowed down in late October and early November, but have picked up since. Until the setback caused by the big storms in the Eastern States their gains over a year ago were widening. Stores are well-stocked and have good commitments. As a result, wholesale trade is not particularly active, but the soft goods industries are working against well-filled order books and their prices are supported by the strength of the cotton and wool markets.

Naturally the trade outlook is dominated by prospective purchasing power, and this in turn by high employment at rising wage rates and by quickening armament orders to take up slack where it appears. The second element is the psychology of consumers, whether the will to buy or the will to save is uppermost. In overall terms, personal saving came to a halt during the month of July, according to the estimates of the Department of Commerce on the disposition of personal incomes. Since July the proportion of income saved has been rising toward a normal figure again. From every viewpoint more saving is desirable. The long-run fear is not that spending will be too little to clear the markets of consumers' goods, but that demand will exceed supplies — in other words, inflation. Everyone has a stake in suppressing inflationary pressures, and in most cases the only way that an individual, in the management of his own affairs, can effectively aid in the battle is to save.

Unfortunately, the inflationary spiral has mounted further during November. The trend of commodity prices has continued upward. The steel industry, as was inevitable, has joined the procession of wage increases and steel prices have been advanced. What is more significant, the publication of the official consumers' price index (cost of living) for October, which rose to a new high of 174.8 (1935-39 = 100), required further wage increases to be granted automatically in cases where escalator contracts based on this index are in force. In nearly all cases workers covered by these contracts had already had increases since the Korean war began.

Thus is illustrated the effect of inflationary mechanisms such as escalator clauses in price and wage contracts. Industrial costs will be raised, price advances will work around the circle, and the parity prices which govern farm price support programs will rise. The increases go around as long as the economic situation will support them. These developments make even more urgent the need to turn more of the income increases from spending into saving, and for governments — state and local as well as national — to reduce their spending in order to diminish the pressure on the markets.

December-January Refunding

The Treasury's plans for handling its \$8 billion bond and certificate maturities on December 15 and January 1 were made public in a brief statement after the close of business on November 22, Thanksgiving Eve:

Secretary of the Treasury Snyder announced today that owners of the Treasury bonds of 1950, maturing December 15, 1950, and owners of the Treasury certificates of indebtedness maturing January 1, 1951, will be offered a 1½ per cent 5-year Treasury note. The bonds will be exchanged par for par on December 15 and the certificates at par with an adjustment of interest on January 1. The new note will be dated December 15, 1950. The subscription books for this offering will open on Monday, December 4. The maturing bonds and certificates are outstanding in the amounts of \$2,635,433,500 and \$5,372,668,000 respectively.

With the background of the ill-starred September-October offerings of 1½ per cent 13-months' notes, which ran afoul of Federal Reserve measures to curb credit inflation, there was more than the usual interest in the Treasury's plans for December-January. The new 1½ per cent five-year notes were well designed in term and coupon to meet market demands and they are encountering a good reception. The maturity falls into a range where there is a relative scarcity of paper and will have a special appeal to investors who like to have their portfolios spaced out in an orderly fashion. The 1½ per cent coupon, the best offered by the Treasury on a marketable security since 1945, should attract some funds that otherwise would find their way into loans.

The omission of one-year paper from the program will serve the incidental purpose of allowing the Federal Reserve to distribute in the market some more of its swollen holdings of 1951 note maturities and achieve a better balance in its portfolio. Federal Reserve holdings of 1951 note maturities on October 4 were up to \$13,865 million, mostly acquired on the September 15 and October 1 refundings. By raising the yield offered the buyer to 1.46 per cent, the Federal Reserve through November 22 had been able to work off \$135 million of these 1951 notes. In the first week following the Treasury's announcement, \$256 million more were sold.

After the \$8 billion December-January refunding is out of the way, the Treasury will have a five-and-a-half months' respite from refundings, there being no maturities of marketable securities except Treasury bills until June 15. In the six months beginning then, \$12 billion in five issues of bonds and \$27 billion in seven issues of notes, including those sold last September and October, will come up for refunding. Secretary Snyder has stated that some new money

borrowing may also be required during this same period.

These concentrations of obligations falling due, or becoming eligible for redemption prior to maturity, offer opportunities to the Treasury to improve the structure of the debt, to spread out the maturities, and to achieve a wider distribution. The December-January refunding terms reflect a flexible approach to public debt management. So long as that is maintained, the Federal Reserve will have space for maneuver and there should be no basis for serious disagreement between the two agencies.

The Budget Situation

As a regular practice, the Bureau of the Budget prepares a "Budget Review", generally in August, taking account of legislative action by the Congress on the President's budget proposals, and changes in program and the revenue outlook. It brings the budget picture up to date. This year no review has yet come out, evidently because the size of the military program is still unsettled. However, actual results for July 1 through November 28 are available and they show a much more favorable situation than had been anticipated. Budget expenditures, at \$14.7 billion, were \$1.8 billion below the corresponding period of last year. Revenues, at \$14.2 billion, were \$0.8 billion larger than last year. The result was a deficit of \$0.5 billion in contrast to one of \$3.1 billion in the July-November 28 period a year ago.

Receipts and Expenditures

(In Millions of Dollars)

	First Five Months of Fiscal Years*		Fiscal Year Totals		
	1951	1950	1950	1948	1945
Total expenditures...	\$14,704	\$16,462	\$40,167	\$33,791	\$98,708
Net budget receipts...	14,178	13,340	37,045	42,211	44,762
Surplus (+) or deficit (—)	—526	—3,122	—3,122	+8,420	—53,941

* Figures are for July 1-November 28.

On the revenue side, individual income taxes and excise taxes are running well ahead of last year and far better than had been expected last January, a reflection of the rise in individual incomes, employment, and spending. There has been an offsetting decline in tax collections from corporations which in September met the third instalment on their reduced 1949 earnings. A year ago corporations were still paying taxes on their 1948 incomes. The gains from the Revenue Act of 1950, and from the rise in 1950 corporate earnings, will raise receipts still higher in the months ahead, most particularly in the January-March quarter, and are reasonably certain to produce for the full fiscal year a revenue total

comparable to the record \$45 billion realized in fiscal '45 — quite apart from further tax levies that are in the prospect. This would be a gain of \$8 billion over the \$37 billion realized in the fiscal year which ended June 30, 1950. Under the assumption of sustained business and personal incomes, the Revenue Act of 1950 will produce a further boost in receipts in fiscal '52.

Expenditures

That expenditures so far this fiscal year have run well below last year has been a matter of surprise to many people in light of the Korean war and the widely publicized speed-up in the military program. The following table, showing expenditures by major classifications, for the July-October period, reveals how this came about. The figures are taken from the Daily Treasury Statement and the expenditure classifications differ somewhat from those in the budget.

	Expenditures (In Millions of Dollars)				
	First Four Months of Fiscal Year		Fiscal Year Totals		
	1951	1950	1950	1948	1945
National defense and related items	\$ 4,561	\$ 4,224	\$12,378	\$11,500	\$90,501
International finance and aid	1,173	1,748	4,657	4,143	—
Veterans Administration	1,778	2,387	6,517	6,469	2,060
Interest on the public debt	1,281	1,246	5,750	5,211	3,617
Aid to agriculture	46	1,123	2,984	782	969
Social Security	916	994	1,967	1,619	807
Public works	615	605	1,577	1,126	313
Other	1,849	1,793	4,337	2,941	436
Total expenditures	\$12,219	\$14,125	\$40,167	\$33,791	\$98,708

Outlays even for the defense category were only moderately higher in July-October, 1950 than in the July-October, 1949 period. Evidently there was a stand-off between enlarged expenditures for procurement (especially of aircraft), stockpiling, and personnel, and falling outlays for other items, particularly costs of occupation in Japan. The real increase in military expenditures still lies ahead, as production and deliveries of weapons and equipment mount and the bills come in. How far the increase will go is still unsettled. For fiscal '51, ending next June, \$20 billion still appears to be an ample estimate. For fiscal '52 estimates range up to \$45 billion or even more. Price inflation itself can force defense costs upwards.

Related to the military program is the Mutual Defense Assistance Program, which comes under the heading of International Finance and Aid. In the July-October period the MDAP was only in its beginning stages while "dollar shortage", relief, and recovery types of foreign aid were contracting, and the aggregate of financial help extended abroad was down one-third in comparison with a year ago.

The decline in foreign aid contributed \$575 million to the \$1.9 billion decrease in total budget expenditures in the July-October period. A larger factor was a drop of \$1084 million in aid to agriculture. This reflected a swing in the position of the Commodity Credit Corporation related to the boom in the cotton market. In July-October a year ago the CCC, to finance cotton purchases and other activities, drew upon the Treasury for \$727 million. This year commercial channels absorbed the small new crop and most of the cotton previously held by the CCC as well. The corporation returned \$359 million to the Treasury, as a credit against expenditures under other programs.

The drop in expenditures by the Veterans Administration is mainly explained by an abnormally large transfer made in September, 1949, to the veterans' life insurance reserve fund, but veterans' readjustment benefits are also running lower. The Reconstruction Finance Corporation, included in "other expenditures", drew less heavily on the Treasury than a year ago but various other agencies and departments increased their outlays. Public works exceeded the record rate of last year.

"A Missing Link"

Some unofficial projections that are going the rounds take the aggregate of nonmilitary government expenditures as something fixed and uncontractable. This is erroneous for two reasons: First, needs for some classes of expenditures, like those of the CCC, veterans' benefits, and relief payments, fall automatically when prices and employment rise. Secondly, Government can, if it will, take positive action to curtail nonmilitary programs.

So far, little more than lip service has been given to the job of cutting back non-essentials in government. Under a Congressional directive included in the "omnibus" appropriation bill, the Bureau of the Budget on October 10 announced that \$580 million of fiscal '51 appropriations for various departments and agencies would be held "in reserve." But, compared to the cutbacks programmed for the civilian economy, via taxes and credit measures, this action is insignificant. The principal effects are to reduce a few planned expansions in program, such as for rural electrification, hospital building, and public works. The cuts in program expansions do not even add up to \$580 million since many of the appropriations placed "in reserve" were applied to agencies and departments, like the ECA, whose needs were reduced by the change in the economic situation. A positive policy of cutting back non-essentials

in government is a vital missing link in the general policy of attacking inflation by fiscal and credit measures.

In voting the directive in the omnibus appropriation bill the Congress had specified that the cuts should be accomplished "without impairing national defense." In signing the bill the President expressed doubts that savings of the proportions sought by Congress could be made "without impairing essential government services." All government programs are apt to seem essential to some one or other. In all-out war, as in 1942-45, many of these programs have to be cut to shreds, and by priorities in favor of military orders if by no other means. In a situation short of that, but still requiring a rapid defense build-up, it should be possible for government to adjust itself to the needs of the situation just as the citizen is being required to do through tax increases, higher prices, and restrictions on his access to credit.

Based on government policies so far pursued, the citizen rightfully can ask: Does all the cutting back of spending have to be by him while every peacetime government project that has ever been thought of and put on the statute books goes merrily on its way, competing with the defense effort for men and material and aggravating shortages for the citizen to bear?

The \$23 Billion Nonmilitary Budget

Senator Harry F. Byrd of Virginia, in presenting last spring a plan for cutting government expenditures by \$6 billion, insisted that interest on the public debt, a contractual obligation which must be honored to sustain the public credit, is the only "untouchable" item in the budget. With the developments since June, many people would consider the accelerating defense program as practically "untouchable," though the need to avoid extravagance is just as imperative there as any place. And the need is greater than ever to deflate the nonmilitary budget. This is swollen, on the basis of the fiscal '51 budget proposals submitted to Congress last January, to \$23.3 billion, the highest level in our history. How much of this can we forego?

The aggregate \$23.3 billion, it should be observed at the outset, is not a figure that ever has been actually spent in a single year, ex-defense and ex-interest. In fiscal 1948, the comparable actual figure was \$17.6 billion, \$5.7 billion lower. Yet the nation prospered. We did not then have the imminent and urgent need to make sacrifices for strengthening defenses that we do now.

Housing and "Welfare"

This, of course, does not answer the question of where cuts can be made. The easiest ones are accomplished by dropping out new programs, of unproved value. Under the headings of "Social Welfare, Health, and Security", "Education and General Research", and "Housing and Community Development" — havens of a growing rash of socialistic enterprises — the fiscal '51 budget document proposed to spend and lend \$4½ billion. Of this amount, \$1 billion can be saved by holding down to the fiscal '49 level federal funds made available for public health, education, and relief. The Congress has already saved part of this money by disapproving "socialized medicine" and greatly enlarged federal subsidies for elementary schools. Beyond that, experience shows that the essential programs in this entire area will be more economically and efficiently administered if the prime financial responsibility is allowed to remain at the State and local level. From this standpoint, the present 52 per cent share of the Federal Government in assistance to the aged and other special groups, which the President proposed to increase, is already too high.

Another \$1 billion of the \$4½ billion can be saved by suspension of home mortgage purchases by the Federal National Mortgage Association. The operations are carried out by the device of "public debt authorizations," without appropriations, but the U. S. Treasury still has to put up the cash. Whatever could be said for this program last January, what has transpired since then calls for an urgent review, not only to tie in to the new credit restrictions on private lenders but to reinforce their effectiveness in saving labor and materials.

Farm Programs and Public Works

The January budget had farm programs down for a total of \$2.2 billion. This figure is out-of-date by as much as \$1 billion simply because of the favorable turn in commodity markets. The Commodity Credit Corporation, for example, instead of buying cotton to hold up the price, as was done last year, has been able to sell off its holdings and return funds to the Treasury.

Meanwhile it has been announced that government purchases of eggs will be suspended in 1951 though only because no one knows what to do with the accumulations. Price support likewise is being withdrawn on potatoes though only after growers in certain areas voted to take their chances on a free market and avoid government-enforced acreage restrictions. The citizen should not have to rely on exhaustion of storage capacity, and the farmers' dislike for regimenta-

tion, to end these systems of calculated waste. The citizen pays twice-over, in taxes and in high food prices, for subsidies which demonstrably are not needed to bring forth an abundant production. The farm programs should fall to a costless basis under boom conditions. They need to be overhauled to make them do so, for a saving of \$2 billion.

Events since Korea redouble the validity of arguments employed by Senator Douglas and others for cutbacks in the soaring public works outlays. In the January budget the Army Corps of Engineers was scheduled to spend \$695 million, the Bureau of Reclamation \$354 million, the Bureau of Public Roads \$493 million, and the Rural Electrification Administration \$436 million—all of them new record figures. Here is \$2 billion which, to save money, labor, steel, and copper, needs an immediate emergency cut to \$1 billion. As a point of reference, the total for this group of items in the last war year, fiscal '45, was \$186 million.

Foreign Aid

On international affairs and finance the January budget had estimated expenditures at \$4.7 billion this fiscal year. It was already apparent by June that this figure was excessive in light of the recovery in foreign dollar-earning capacity, and diminishing need for Marshall plan assistance. The accelerated build-up in foreign gold and dollar reserves since June calls for a further downward revision. At the same time the pressure of world events has shifted the emphasis of foreign aid from economic to military. As Dr. Richard M. Bissell, Jr., Deputy ECA Administrator, stated two weeks ago: "This military aid, and the continuation of assistance to a few of the countries in which recovery has lagged, can all be accomplished with vastly smaller sums than the Marshall Plan required." This generally corresponds to the findings of Mr. Gordon Gray in his report to the President on foreign economic policies. Neither Mr. Bissell nor Mr. Gray mentioned figures but a reduction of \$2 billion would seem possible and desirable at this writing.

Summed up, possible cuts in five areas—\$1 billion in housing loans, \$1 billion in new "welfare" programs, \$1 billion in public works, \$2 billion in farm subsidies, and \$2 billion in foreign aid programs—aggregate \$7 billion. And even this figure could be improved upon by a general house-cleaning of marginal programs in every department, with special emphasis on easy lending, easy spending activities premised on the notion that the Federal Government, or the taxpayer, has no end of money.

The Best Anti-Inflation Medicine

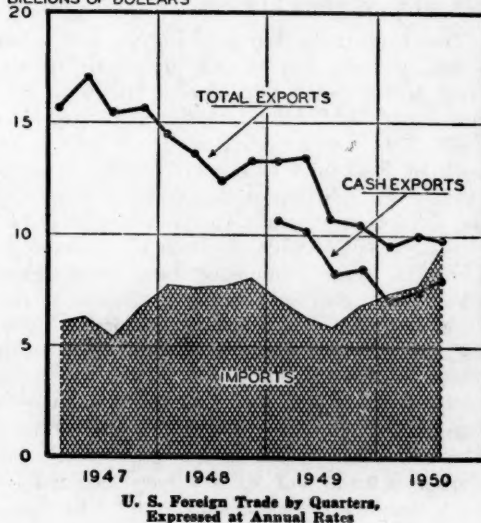
Stripping out the chaff in government gives the best value, dollar for dollar, of all the anti-inflationary medicines. The alternative of a corresponding tax increase, for example, weakens the financial rewards for extra effort, trenches on savings, and tends to push up wages and prices as employers and employees seek redress for their added expenses. Higher taxes will be accepted with far less disturbance to morale and to economic stability if they are preceded by a genuine effort at retrenchment in government.

Recovery in Foreign Dollar Earnings and Reserves

While the facts are being collected and recommendations formulated to help the new Congress in re-examination of the foreign economic policies, dollar holdings by foreign countries are accumulating at a considerable pace. In reflection of this turn of events, and pending further review, the Economic Cooperation Administration has suspended direct Marshall Plan aid to the United Kingdom, which has experienced the most dramatic switch-about in its position.

A number of factors have contributed to the change in our balance of payments: the success in restoring European production; the readjustment of international currency values to a more realistic basis in September, 1949; and the continued supply of \$4 to \$5 billion a year under U. S. Government loan and grant programs. But most important in recent months has been sharply increased imports by the United States of industrial materials such as rubber, wool, tin and other non-ferrous metals, man-

BILLIONS OF DOLLARS



ganese, and lumber. Some of these are being bought for stockpiling as well as for current use and record high prices are being paid to get them. Our imports of woodpulp and newsprint, oil, coffee, sugar, cocoa, and specialized foreign manufactures likewise are generating increased dollar earnings abroad. In total, dollars are now flowing out to pay for imports at a rate of \$10 billion a year — beyond any precedent.

Our merchandise exports, which reached an extreme peak above \$15 billion in 1947, meanwhile are holding stable at a rate roughly equal to the imports or \$10 billion a year. If exports paid for by the U. S. Treasury under various aid programs are eliminated, as will be seen from the chart above, we have had in our cash trade a considerable adverse trade balance this year.

Trade by Areas

The largest single share of our trade is accounted for by Canada, where each way it is running at a rate better than \$2 billion a year. American machinery and equipment, prefabricated steel, petroleum products, and coal are moving to Canada principally in exchange for woodpulp and newsprint, lumber, foodstuffs, non-ferrous metals and other minerals. From Latin American countries taken as a group, with the high prices of coffee, wool, and non-ferrous metals, our imports during the third quarter reached an annual rate of \$3.5 billion. Exports, mainly manufactured goods of every type, ran at a rate of \$2.7 billion a year in the same quarter. Thus the trade with Latin America is generating a big dollar surplus, of which part is replenishing reserves, part is being used to settle arrears, and part is paying for goods bought in Western Europe.

Our exports to Western Europe are in reduced volume and during the third quarter were at an annual rate of \$2.3 billion as compared with \$3.2 billion in the same period in 1949. This change reflected smaller shipments both of foodstuffs and manufactures. On the other hand, U. S. imports from Western Europe in the third quarter reached an annual rate of \$1.3 billion, nearly double the rate of a year ago. European steel, chemicals, and manufactured goods in general are helping to fill our current high industrial and consumer demands. Thus the dollar deficiency of Western Europe in direct trade with the United States was down to about \$1 billion a year as compared with a rate of \$2.5 billion in the third quarter of 1949. The reduction of the dollar gap in Western European trade with us has been accompanied by a considerable expansion of intra-European

trade, some 60 per cent of which is now freed of quantitative restrictions.

The shift in our trade with some individual European countries has been considerable. With Great Britain, our imports during the third quarter reached \$97 million, up 43 per cent over the similar period of last year, before the pound devaluation. Our exports to Great Britain, reflecting tight restrictions on dollar availabilities in Britain, were \$125 million in the third quarter, down 16 per cent from last year. The increase in British currency reserves, which amounted to \$334 million in the third quarter, was not, of course, a result of direct trade with us. The principal source was dollar earnings of the overseas sterling area countries, such as Australia, Malaya, Ceylon and West Africa, representing the proceeds from sale of rubber, tin, wool, cocoa, and other products. Our imports from these countries, at \$316 million in the third quarter, more than doubled the figure for the same quarter of 1949. Another source of dollars was forward covering of sterling requirements by traders, and speculative buying of sterling, which accompanied rumors that its value might be raised.

Our third quarter imports of \$35 million from France, \$26 million from Germany, \$27 million from Italy, and \$48 million from Japan, represent marked increases over the low levels in the same period last year. Aggregate foreign trade in each of these countries has undergone a like improvement and is in much better balance than a year ago. German and Japanese export volumes, running now at \$2 billion and \$800 million a year respectively, have dissipated the somewhat gloomy views of the economic prospects in both countries.

Along with trade, service transactions are likewise generating more dollars abroad. With many of our ships assigned to army supply duties, we are having to rely more on merchant fleets of friendly foreign powers. Also, American tourists this year spent more abroad than ever before.

The Growth of Reserves

In consideration of the fact that Marshall aid to Europe has been gradually slowing down, according to plan, the growth in foreign gold and dollar reserves has been phenomenal. The change dates back to September, 1949, when currencies were realigned on a world-wide basis. The U. S. gold reserve, at \$24.6 billion, was at its zenith. Since then, foreign countries, taken collectively but ex-Russia, have probably added \$700 million to their reserves directly from new gold production. From the surplus supply of dollars made available by American loan and aid

programs and other transactions, \$1.5 billion has been converted into gold, producing an overall recovery in gold reserves of \$2.2 billion for foreign countries outside of the Russian orbit.

Only part of the dollars accruing to foreigners has been converted into gold. The remainder is represented, mainly, in increased deposit balances with American banks, and short-term investments in the American market. Such dollar holdings increased \$1.1 billion from September, 1949 through August, 1950 and may have risen another half billion by the end of November. If gold and dollars are taken together, the recovery in foreign holdings (ex-Russia) probably runs to \$3½ or \$4 billion in fourteen months. The change is for the good insofar as increased reserves provide a basis for confidence in currency values and lead to relaxations of exchange barriers to trade and travel within the "free world".

Questions Raised

The radical shift from a situation of dollar shortage to one of dollar surplus, and the imperative need for military build-up, creates a variety of new questions for American policy. One policy change has already been referred to, namely, the suspension of Marshall Plan aid to the United Kingdom. The Report to the President on Foreign Economic Policies, prepared at his request by Mr. Gordon Gray and published November 10, expresses the view that the programs needed to build adequate defensive strength involve "a re-examination of our objectives and capabilities both within our own country and in our foreign programs." Mr. Gray states that total requirements of the foreign aid programs, including loans and grants, "should be substantially less than we have been spending for these purposes during the past year." These programs should still encompass, Mr. Gray holds, expanded technical and financial assistance to "underdeveloped" countries, and aids specifically related to the burden of rearmament efforts.

The Gray report contains sound advice on the place of dollar aids in the critical world situation:

A sound structure of international economic relationships cannot rest on dollar subsidies. These should be viewed as essential supplements, in specific cases, to policies designed to develop the unity of political purpose, the attitudes, and the trading and financial relationships that can provide a continuing basis for progress along sound economic lines. Where they do not serve these purposes, mere dollar subsidies may do more harm than good: they may perpetuate maladjustments, reduce efficiency and incentives, and intensify social cleavages within receiving countries. Dollar aid is a catalyst and not a sustaining fuel. It must be accompanied by a

demonstration of self-help, and of the possibility for accomplishing the objectives in mind.

The role of dollar aid is, in any case, limited by our own requirements for economic growth and military strength. The ability to make effective use of our total resources and to maintain the dynamic nature of our economy will be severely tested in the long-term struggle ahead. We must therefore make a continuing evaluation of the relationship between our commitments and our capabilities. As success is achieved in broadening the unity of purpose, based on mutual interest among free peoples, we may reasonably expect a greater sharing of the burden of security and development requirements.

The "Colombo Plan", published November 28 by the Governments of Australia, Canada, Ceylon, India, New Zealand, Pakistan, and the United Kingdom, meets the point Mr. Gray makes, that the cost of development should be shared. The plan, initiated by the seven British Commonwealth Governments, is for a "comprehensive and cooperative attack on the problem of poverty and economic underdevelopment in South and South-East Asia." A six-year program, involving \$3 billion in outside capital, is envisaged. While the plan clearly hinges on contributions of American capital and technical assistance, it includes the essential element of self-help and a distribution of the burden among both Commonwealth and non-Commonwealth countries. For example, the United Kingdom would propose to cover nearly one-quarter of the external financial aid by releases of blocked sterling balances.

Smaller Companies Also Growing

The publicity given to the record-breaking volume of sales and earnings reported this year by many of the country's largest industrial companies, such as General Motors, General Electric, and U. S. Steel, tends to emphasize the growth of the big companies without revealing the fact that large numbers of the smaller concerns in American industry are growing at an even faster rate. An immense amount has been written in recent years about "monopoly" and "concentration", big companies "gobbling up the little fellows", and the difficulties of "small business". Reports have been issued by the Federal Trade Commission stressing the considerable number of companies that have disappeared through merger since 1940, even though during the same period forty times that many new companies have been established. The effect of such statements is to persuade many people that there is no longer much opportunity for smaller enterprises to expand, as they must if we are to have a dynamic economy.

But although this impression is widespread, the facts show that small companies are grow-

ing into medium-sized ones, and medium-sized concerns into larger ones, as they have always done in American industrial history. At the same time, the prosperity of most large companies is tied closely with that of the many smaller ones upon which they depend as suppliers, subcontractors, and distributors.

In the following table we summarize sales figures for 292 companies which prior to 1945 issued no financial statements for the reason that they were relatively small or medium-sized and closely held, but which have been issuing statements since, so that their experience between 1945 and 1949 can be measured.

Growth in Sales, 1945 to 1949, of 292 Manufacturing Corporations Which Began Publication of Financial Statements Since January 1, 1945, Classified by Size of 1945 Sales

1945 Sales Class	Number of Companies	Total Sales In Millions		Per Cent Change
		1945	1949	
Under \$2.5 Million	85	\$ 136	\$ 264	+94
\$2.5-5 Million	73	259	396	+53
\$5-10 Million	81	678	904	+56
\$10-15 Million	30	367	546	+49
\$15-20 Million	13	218	292	+34
\$20-25 Million	10	223	268	+20
Total Under 25 Million	292	\$1,781	\$2,670	+50
All manufacturing corporations in the U. S.		\$188,725	\$182,403	+31

The companies covered in this table embrace almost every major branch of industry, distributed geographically over 33 different States.

It will be recognized that these in the main are successful companies. The principal reasons why their statements have been made public are that they needed to raise new capital, or that the owners wished to make a market for some of their own stock, perhaps in anticipation of retirement and of estate taxes. Their ability to convert themselves into publicly-owned companies is a mark of success. Hence it cannot be claimed that their growth is wholly typical. The important matter, however, is that the instances of growth and successful competition are numerous and striking. Far from being driven from the field, many smaller companies are growing year after year at a more rapid rate than their biggest competitors in the same fields.

50 Per Cent Sales Increase

It will be seen that these new statements show an increase in total sales from approximately \$1.8 billion in 1945 to \$2.7 billion in 1949, a gain of 50 per cent. About seven out of every ten individual companies registered an increase; the remainder experienced a decrease, due to the termination of large war contracts or inability to maintain their competitive positions after the war. For the manufacturing industries as a whole, the increase from 1945 to 1949 in dollar sales was 31 per cent. Part of the increase in

Partial List of Manufacturing Corporations Which Began Publication of Financial Statements Since January 1, 1945

Company	Location	1949 Sales (Millions)
Airline Foods Corp.	Linden, N. J.	\$19
Louis Allis Co.	Milwaukee, Wis.	13
Amer. Hoist & Derrick Co.	St. Paul, Minn.	12
Amer. Metal Products Co.	Detroit, Mich.	20
Anderson-Prichard Oil Corp.	Oklahoma City, Okla.	26
Apex Smelting Co.	Chicago, Ill.	13
Arcady Farms Milling Co.	Chicago, Ill.	15
Associated Spring Corp.	Bristol, Conn.	27
Avon Allied Products, Inc.	New York, N. Y.	26
B. T. Babbitt, Inc.	New York, N. Y.	17
Ballard & Ballard Co.	Louisville, Ky.	31
Bay Petroleum Corp.	Denver, Colo.	30
Bell Company	Worcester, Mass.	13
Bell & Howell Co.	Chicago, Ill.	13
Benrus Watch Co.	New York, N. Y.	11
Bingham-Herbrand Corp.	Toledo, Ohio	11
Black, Sivalls & Bryson	Kansas City, Mo.	16
Blue Bell, Inc.	New York, N. Y.	37
Geo. W. Borg Corp.	Delevan, Wis.	11
Brockway Glass Co.	Brockway, Pa.	11
Burton-Dixie Corp.	Chicago, Ill.	16
Capitol Records, Inc.	Hollywood, Calif.	11
Cascades Plywood Corp.	Portland, Ore.	12
Chase Candy Co.	St. Louis, Mo.	14
Combined Locks Paper Co.	Combined Locks, Wis.	11
Continental Gin Co.	Birmingham, Ala.	13
Cont. Copper & Steel Industries	New York, N. Y.	21
Cornell Wood Prod. Co.	Chicago, Ill.	19
Cummins Engine Co.	Columbus, Ind.	23
Curtis Companies	Clinton, Ia.	14
Douglas & Lomason Co.	Detroit, Mich.	11
Douglas Oil Co. of Calif.	Paramount, Calif.	16
Drexel Furniture Co.	Drexel, N. C.	13
Fabricon Products, Inc.	River Rouge, Mich.	18
Max Factor & Co.	Hollywood, Calif.	15
Fashion Frocks, Inc.	Cincinnati, O.	12
Firth Carpet Co.	New York, N. Y.	16
Ft. Wayne Corrugated Paper Co.	Ft. Wayne, Ind.	11
Fram Corporation	Providence, R. I.	15
Frontier Refining Co.	Cheyenne, Wyo.	14
Georgia-Pacific Plywood & Lum. Co.	Augusta, Ga.	35
Gerber Products Co.	Fremont, Mich.	42
Gibson Refrigerator Co.	Greenville, Mich.	42
Globe-Union, Inc.	Milwaukee, Wis.	29
Goldsmith Bros. Sm. & Ref. Co.	Chicago, Ill.	19
Hoffman Radio Corp.	Los Angeles, Calif.	12
Hubinger Company	Keokuk, Ia.	12
Hudson Pulp & Paper Corp.	New York, N. Y.	22
Hytron Radio & Elec. Corp.	Salem, Mass.	16
I-T-E Circuit Breaker Co.	Philadelphia, Pa.	30
Kroehler Manufacturing Co.	Naperville, Ill.	45
James Lees & Sons Co.	Bridgeport, Pa.	48
Longines-Wittnauer Watch Co.	New York, N. Y.	14
M. & M. Wood Working Co.	Portland, Ore.	25
Maremont Automotive Products	Chicago, Ill.	12
Meredith Publishing Co.	Des Moines, Ia.	24
Miles Laboratories, Inc.	Elkhart, Ind.	21
Mohawk Petroleum Corp.	San Francisco, Calif.	12
Morris Paper Mills	Chicago, Ill.	13
Natl. Aluminate Corp.	Chicago, Ill.	12
Natl. Mallinson Fabrics Corp.	New York, N. Y.	24
Natl. Starch Products	New York, N. Y.	16
Natl. Tank Co.	Tulsa, Okla.	16
Natl. Vulcanized Fibre Co.	Wilmington, Del.	12
Northwestern Leather Co.	Boston, Mass.	14
Permanente Cement Co.	Oakland, Calif.	20
Plymouth Rubber Co.	Canton, Mass.	11
Purex Corp., Ltd.	South Gate, Calif.	14
Robbins Mills, Inc.	New York, N. Y.	35
Roosevelt Oil & Refining Corp.	Mt. Pleasant, Mich.	26
G. D. Searle & Co.	Skokie, Ill.	12
Seeger Refrigerator Co.	St. Paul, Minn.	69
Shedd-Bartush Foods	Detroit, Mich.	19
Smith, Kline & French Laboratories	Philadelphia, Pa.	40
Sprague Electric Co.	N. Adams, Mass.	15
Standard Forgings Corp.	Chicago, Ill.	14
Std. Rwy. Equip. Mfg. Corp.	Chicago, Ill.	17
Stanley Home Products, Inc.	Westfield, Mass.	35
Taylor Instrument Cos.	Rochester, N. Y.	13
Thomas Steel Co.	Warren, Ohio	11
Timely Clothes, Inc.	Rochester, N. Y.	11
Towmotor Corp.	Cleveland, Ohio	11
Uarco, Inc.	Chicago, Ill.	13
U. S. Spring & Bumper Co.	Los Angeles, Calif.	13
Universal Winding Co.	Providence, R. I.	21
Van Camp Sea Food Co.	Vernon, Calif.	39
Viking Corp.	Chicago, Ill.	39
Western Condensing Co.	San Francisco, Calif.	13
Wicks Corporation	Saginaw, Mich.	11
Wilson Brothers	Chicago, Ill.	17

sales was due, of course, to the general rise of prices, which inflated also the reported earnings and the taxes payable unless inventories were carried on the "last-in, first-out" basis.

When the substantial increases shown by the new statements are divided according to size of sales in 1945, the gains shown by the smaller companies become even more impressive. There were 85 companies having 1945 sales under \$2.5 million—a sizeable volume, though relatively small for the manufacturing industries—which by 1949 had a combined gain of 94 per cent. The first three groups, having 1945 sales under \$10 million and comprising over four-fifths of the total number, all had gains of over 50 per cent, whereas the larger companies had progressively smaller increases.

The diversified character of these companies which have entered the public investment market, and their importance in the growth of the country's industrial employment and production, are illustrated by the foregoing list.

Turnover and Taxes

It is sometimes assumed that when a business organization has once become firmly established, it thereafter runs along almost automatically and usually enjoys a long lease on life. This might seem particularly likely when an organization has attained large size.

The records of individual businesses, however, have provided little basis for such an assumption. Moreover, data on the ages of all corporations in the United States, never before available until published this fall by the Treasury Department, illustrate the constant turnover of corporations in the manufacturing industries and the relative youth of the business population. These are included as a special tabulation in the final report on "Statistics of Income for 1945," condensed in the accompanying table:

Ages of All Manufacturing Corporations in the United States on December 31, 1945

Date Incorporated	Total Number	Per Cent of Total
1940-45	19,877	25.7
1930-39	23,367	30.2
1920-29	16,144	20.9
1910-19	8,636	11.2
1900-09	6,056	7.8
Before 1900	3,256	4.2
Total	77,326	100.0

It will be seen that of the total of some 77,000 active manufacturing corporations reporting at the end of the year 1945, over half were less than 16 years old. About 40 per cent were in-

corporated during the three decades 1900-29, and only 4 per cent before 1900. While dates of incorporation do not in all cases measure the total age of a business, the Treasury Department found that about three-fourths of all companies incorporated in 1945 represented businesses established in that year, with the remainder successors to other corporations, partnerships, or individual proprietorships.

These official statistics of corporate age indicate that even a successful business organization has no more assurance of permanence than a winning baseball team—unless it keeps on its toes, takes in able new personnel, and constantly changes its ideas and methods to meet prevailing conditions.

The large numbers of manufacturing enterprises, as illustrated by the above sample, which continue to forge ahead in the competition for consumer patronage show that success stories in American business are still being written. Big businesses are still growing, but smaller businesses also are growing—and often at a faster rate. Our economic progress and the rise in living standards ever since this country was established have been based on industrial growth, and our future welfare will depend on keeping the way open for growth.

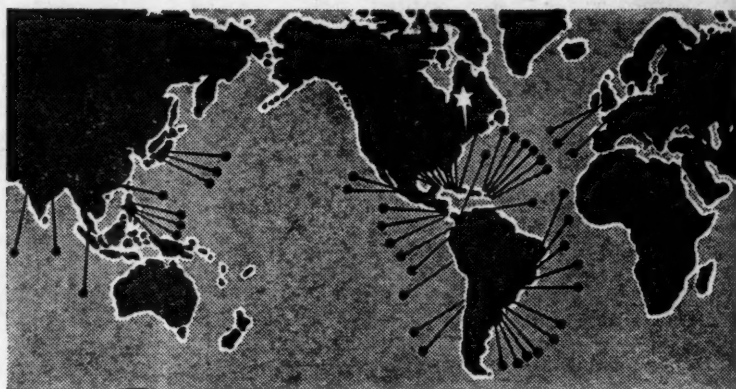
One of the most serious handicaps to industrial growth is excessive taxation, especially in the case of the small and intermediate size enterprises which depend mainly on retained earnings to provide the capital needed to finance their expansion. In view of the vigorous gains in postwar sales achieved by this group of almost 300 manufacturing companies, which took place under a 38 per cent corporate tax rate, it is clear that financing the increased capital requirements would have been much more difficult, if not impossible, had a stiff excess profits tax been in effect and drained off most of the operating earnings.

A high excess profits tax such as is now being considered, together with the 45 per cent corporate normal and surtax, would impose a heavy penalty on growing companies because their credits, based either on prior years' earnings or on invested capital, would be small compared to present capital requirements. Taxing away their "excess" income over inadequate credits would leave them little to plough back into the business and to attract the new capital needed for growth.

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